

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE
CONTRACTOR'S PENSION
SEGMENTATION, ADMINASTAR
FEDERAL OF KENTUCKY**



JUNE GIBBS BROWN
Inspector General

OCTOBER 1998
A-07-97-01223



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

CIN: A-07-97-01223

OCT 14 1998

Mr. Robert B. Fleming
Vice President and Chief Financial Officer
AdminaStar Federal
9901 Linn Station Road, Suite 400
Louisville, Kentucky 40223-3824

Dear Mr. Fleming:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Pension Segmentation, AdminaStar Federal of Kentucky*. The purpose of our review was to evaluate AdminaStar Federal of Kentucky's (Kentucky) compliance with the pension segmentation requirements of its Medicare contract.

Our review showed that Kentucky understated Medicare segment pension assets as of October 1, 1994 by \$1,236,890. The understatement primarily occurred because Kentucky did not make the correct transfer adjustment. We recommend that Kentucky increase the October 1, 1994 assets of the Medicare segment by \$1,236,890. The auditee did not provide a response to our report.

INTRODUCTION

BACKGROUND

Kentucky administered Medicare Part A under cost reimbursement contracts since the start of the Medicare program and Medicare Part B since 1982. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

Kentucky's contract required (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the above ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

... any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

- 1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or*
- 2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.*

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan, as of the later of the first day of the first plan year starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment first existed.

To ensure that contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989.

Kentucky's questionnaire response identified total pension assets of \$26,936,073, Medicare

Part A segment assets of \$1,734,279 and Medicare Part B segment assets of \$66,424 as of October 1, 1986.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards, except that we have not reported the auditee's views concerning our findings, conclusions, and recommendations. We repeatedly solicited, but did not receive, Kentucky's comments on our report. Kentucky's failure to respond to our report does not change the results of the audit.

Our objective was to determine Kentucky's compliance with pension segmentation requirements of its Medicare contract. Achieving the objective did not require a review of Kentucky's internal control structure. The audit addressed Kentucky's initial determination of pension assets for its Medicare segments and later updates. Our review covered October 1, 1981 to January 1, 1996.

We performed this review in conjunction with our audits of unfunded pension costs (CIN: A-07-98-01224) and pension costs claimed for Medicare reimbursement (CIN: A-07-98-01225). The information obtained and reviewed during those audits was also used in performing this review.

We reviewed Kentucky's identification of the Medicare segment as of October 1, 1988 and traced the segment's organizational lineage back to 1981. We also reviewed Kentucky's computation of the asset fractions and its update of Medicare assets from October 1, 1986 to October 1, 1994.

In performing the review, we used information provided by Kentucky's consulting actuarial firms. The information included liabilities, normal costs, contributions, expenses, and earnings. We reviewed Kentucky's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we calculated the asset fractions, determined the 1986 Medicare segment assets, and updated the Medicare segment assets to January 1, 1996. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at Kentucky's corporate offices in Louisville, Kentucky during August and September 1997. Subsequently, we performed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

MEDICARE ASSETS AS OF OCTOBER 1, 1986

From October 1, 1986 through September 30, 1992 Kentucky updated both Medicare Part A and Part B segments assets using the actuarial value of assets (AVA). Starting with October 1, 1992, Kentucky converted the update to the market value of assets (MVA). We have included our computations of the audited 1986 Medicare segment assets using both the AVA and the MVA. However, for simplicity, we consistently used the MVA for our entire update.

We determined that Kentucky's Part A asset fraction was overstated by 0.3182 percent. We decreased the asset fraction from 6.4385 percent to 6.1203 percent by identifying the Medicare segment participants using cost center information. Additionally, the difference results from our inclusion of the ancillary benefits in the 1981 total actuarial liability for the total company. The following schedule shows the details of Kentucky's and our calculations.

	1981 Total Actuarial Liability (A)	1981 Medicare Actuarial Liability (B)	1981 Rounded Asset Fraction (C)=(B)/(A)	1986 Total Company Assets (D)	1986 Medicare Segment Assets (E)=(C)(D)
OIG (using MVA)	\$18,925,208	\$1,158,274	6.1203 %	\$29,974,452	\$1,834,526
OIG (using AVA)	\$18,925,208	\$1,158,274	6.1203 %	\$26,936,073	\$1,648,568
Kentucky 1/	\$17,868,630	\$1,150,473	<u>6.4385 %</u>	\$26,936,073	\$1,734,279
Difference			-0.3182 %		

1/ Total actuarial liability on data file did not include ancillary benefit. We included the ancillary benefits in our computations.

We determined that Kentucky's Part B asset fraction was understated by 0.0035 percent. We increased the asset fraction from .2466 percent to .2501 percent by identifying the Medicare segment participants using cost center information. Additionally, the difference results from our inclusion of the ancillary benefits in the 1983 total actuarial liability for the total company. The following schedule shows the details of Kentucky's and our calculations.

	1983 Total Actuarial <u>Liability</u> (A)	1983 Medicare Actuarial <u>Liability</u> (B)	1983 Rounded Asset <u>Fraction</u> (C)=(B)/(A)	1986 Total Company <u>Assets</u> (D)	1986 Medicare Segment <u>Assets</u> (E)=(C)(D)
OIG (using MVA)	\$24,651,905	\$61,655	0.2501%	\$29,974,452	\$74,966
OIG (using AVA)	\$24,651,905	\$61,655	0.2501%	\$26,936,073	\$67,367
Kentucky 1/	\$23,213,317	\$57,239	<u>0.2466%</u>	\$26,936,073	\$66,424
Difference			0.0035%		

1/ Total actuarial liability on data file did not include ancillary benefit. We included the ancillary benefits in our computations.

As of October 1, 1986 we identified for the start of our update of assets, Medicare Part A segment assets of \$1,834,526 and Medicare Part B segment assets of \$74,966 on the MVA basis. We identified Medicare Part A segment assets of \$1,648,568 and Medicare Part B segment assets of \$67,367 on the AVA basis. In comparison, Kentucky identified for the start of their update of assets, Medicare Part A segment assets of \$1,734,279 as of October 1, 1986 for a difference of \$100,247 (\$1,834,526 less \$1,734,279). Additionally, Kentucky identified Medicare Part B segment assets of \$66,424 as of October 1, 1986 for a difference of \$8,542 (\$74,966 less \$66,424).

MEDICARE ASSET BASE AS OF OCTOBER 1, 1986 UPDATED TO OCTOBER 1, 1994

Kentucky's methodology in updating the Medicare segment assets from October 1, 1986 to October 1, 1994 understated the Medicare segment assets by \$1,128,101 (Medicare Part A by \$800,972 and Medicare Part B by \$327,129). This understatement resulted primarily from Kentucky not making the correct transfer adjustment. When considered with the 1986 adjustment, Kentucky understated Medicare's pension assets by \$1,236,890 as of October 1, 1994.

Participant Transfers

In the update of pension assets, Kentucky misidentified Medicare segments participants. Kentucky incorrectly included participants in non-Medicare segment cost centers and incorrectly excluded participants in Medicare segment cost centers.

Since the identification of the segment participants was incorrect, transfers (representing the movement into and out of the segment each year) in the updates were also incorrect. The following table compares computations of transfer amounts.

Transfer Adjustment to the Medicare Segments

<u>Year</u>	<u>OIG</u>	<u>Kentucky</u>
1986	\$176,386	\$0
1987	\$6,184	\$704
1988	\$121,223	(\$486,392)
1989	(\$283,331)	(\$6,760)
1990	\$454,623	(\$166,646)
1991	(\$384,719)	\$241,516
1992	\$407,989	\$184,402
1993	\$1,220,046	\$298,484
Total	<u>\$1,718,401</u>	<u>\$65,308</u>

We corrected the identification of the segment participants and transfer amounts in updating the Medicare segment pension assets. See Appendix A. Our corrections to the transfer amounts increased the Medicare segment assets by \$1,653,093 (\$1,718,401 less \$65,308).

Pension Contributions

Kentucky's update methodology allocated total company contributions to the segment based on the ratio of segment's payroll to total company payroll for plan year 1986. For plan year 1986 we also allocated the contribution to the segment based on the ratio of the segments' payroll to total company payroll. For plan year 1987 we assigned total company contributions to the segment based on the ratio of the segment's CAS funding target to the total company CAS funding target. Our methodology decreased Medicare segment assets by \$194,397 (Medicare Part A by \$75,741 and Medicare Part B by \$118,656).

Benefit Payments

Kentucky provided us with documentation to support the benefits paid by the segments in total only, they were unable to provide this support to the individual level. We identified the benefits paid to Medicare A and B non-actives and included these payments in our update of segments' assets. Our corrections to the benefit payments reduced the Medicare A assets by \$57,689 and increased the Medicare B assets by \$19,872.

Investment Return

Kentucky's update methodology for Plan Years 1986 through 1994 allocated investment return (investment earnings less administrative expenses) to the Medicare segment based on the

average asset value each year, weighted for contributions and benefit disbursements as if such transactions occurred uniformly throughout the year. Because Kentucky's asset amounts were incorrect, it overstated the segment's investment return. Except for correcting asset amounts, as previously described, we used Kentucky's allocation methodology in our update and decreased the Medicare segment assets by \$292,778 (Medicare Part A by \$56,477 and Medicare Part B by \$236,301).

We recommend that Kentucky increase the pension assets of the Medicare segment by \$1,236,890 as of October 1, 1994. The increase of \$1,236,890 resulted from: (1) revising the asset fraction (\$108,789 increase), (2) adjusting for participants that moved in and out of the Medicare segment (\$1,653,093 increase), (3) revising earnings (\$292,778 decrease), (4) adjusting benefit payments (\$37,817 decrease), and (5) assigning pension contributions equitably to the Medicare segment (\$194,397 decrease).

Recommendation:

We recommend that Kentucky:

- ① Increase the pension assets of the Medicare segment by \$1,236,890 as of October 1, 1994.

MEDICARE ASSET BASE AS OF OCTOBER 1, 1994 UPDATED TO JANUARY 1, 1996

Kentucky did not provide to its consulting actuarial firm, William M. Mercer-Meidinger, Incorporated, with the information necessary to update the Medicare segment assets from October 1, 1994 to January 1, 1996. Although Mercer-Meidinger prepared total company valuation reports and updated the total company assets they did not update the Medicare segment assets during this period.

We were able to obtain the information necessary to update the Medicare segment assets from October 1, 1994 to January 1, 1996. We utilized the same methodologies in our update to January 1, 1996 as utilized in our update from October 1, 1986 to October 1, 1994.

We recommend that Kentucky:

- ② Identify Medicare Part A segment assets of \$2,451,370 and Medicare Part B segment assets of \$1,306,988 as of January 1, 1996 (See Appendix A).

Auditee Response

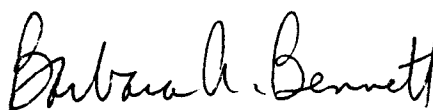
As previously stated, Kentucky did not provide a response to our report.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS, reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise.
(See 45 CFR Part 5).

Sincerely,

A handwritten signature in black ink that reads "Barbara A. Bennett". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Barbara A. Bennett
Regional Inspector General
for Audit Services, Region VII

HHS Action Official:

Ms. Rose Crum-Johnson
Regional Administrator, Region IV
Health Care Financing Administration
Atlanta Federal Center
61 Forsyth Street SW, Suite 4T20
Atlanta, Georgia 30303-8909

Enclosures

ADMINASTAR FEDERAL

CIN: A-07-97-01223

STATEMENT OF MEDICARE PENSION ASSETS
OCTOBER 1, 1986 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare A	Medicare B
Assets October 1, 1986	<u>1/</u>	\$29,974,452	\$28,064,960	\$1,834,526	\$74,966
Contributions	<u>2/</u>	\$2,503,755	\$2,389,916	\$43,642	\$70,197
Investment Return	<u>3/</u>	\$3,508,998	\$3,290,437	\$208,771	\$9,790
Benefit Payments	<u>4/</u>	(\$777,563)	(\$753,982)	(\$23,581)	\$0
Transfers	<u>5/</u>	\$0	(\$176,386)	\$160,688	\$15,698
Assets October 1, 1987		\$35,209,642	\$32,814,945	\$2,224,046	\$170,651
Contributions		\$2,937,403	\$2,472,299	\$153,723	\$311,381
Investment Return		\$509,275	\$474,941	\$30,952	\$3,382
Benefit Payments		(\$2,324,307)	(\$2,309,231)	(\$15,076)	\$0
Transfers		\$0	(\$6,184)	\$40,942	(\$34,758)
Assets October 1, 1988		\$36,332,013	\$33,446,770	\$2,434,587	\$450,656
Contribution		\$0	\$0	\$0	\$0
Investment Return		\$4,615,408	\$4,265,941	\$297,169	\$52,298
Benefit Payments		(\$2,145,428)	(\$2,039,330)	(\$52,468)	(\$53,630)
Transfers		\$0	(\$121,223)	\$127,326	(\$6,103)
Assets October 1, 1989		\$38,801,993	\$35,552,158	\$2,806,614	\$443,221

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OCTOBER 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare A	Medicare B
Assets October 1, 1989	\$41,271,973	\$37,657,546	\$3,178,641	\$435,786
Contribution	\$0	\$0	\$0	\$0
Investment Return	\$2,071,374	\$1,919,277	\$131,747	\$20,350
Benefit Payments	(\$5,947,927)	(\$5,583,314)	(\$299,016)	(\$65,597)
Transfers	\$0	\$283,331	(\$124,613)	(\$158,718)
Assets October 1, 1990	\$37,395,420	\$34,276,840	\$2,886,759	\$231,821
Contribution	\$0	\$0	\$0	\$0
Investment Return	\$5,826,060	\$5,384,653	\$404,565	\$36,842
Benefit Payments	(\$1,663,266)	(\$1,573,515)	(\$63,470)	(\$26,281)
Transfers	\$0	(\$454,623)	\$187,845	\$266,778
Assets October 1, 1991	\$4,162,794	\$3,356,515	\$528,940	\$277,339
Contribution	\$0	\$0	\$0	\$0
Investment Return	\$3,915,592	\$3,568,066	\$298,312	\$49,214
Benefit Payments	(\$1,494,930)	(\$1,445,545)	(\$17,555)	(\$31,830)
Transfers	\$0	\$384,719	(\$207,250)	(\$177,469)
Assets October 1, 1992	\$6,583,456	\$5,863,755	\$602,447	\$117,254

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OCTOBER 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare A	Medicare B
Assets October 1, 1992	\$41,508,896	\$38,035,207	\$3,117,179	\$356,510
Contribution	\$0	\$0	\$0	\$0
Investment Return	\$4,195,484	\$3,878,180	\$283,214	\$34,090
Benefit Payments	(\$2,290,553)	(\$1,795,055)	(\$475,643)	(\$19,855)
Transfers	\$0	(\$407,989)	\$24,563	\$383,426
Assets October 1, 1993	\$43,413,827	\$39,710,343	\$2,949,313	\$754,171
Contribution	\$0	\$0	\$0	\$0
Investment Return	(\$408,080)	(\$375,289)	(\$26,352)	(\$6,439)
Benefit Payments	(\$3,391,914)	(\$3,234,898)	(\$72,356)	(\$84,660)
Transfers	\$0	(\$1,220,046)	\$224,171	\$995,875
Assets October 1, 1994	\$39,613,833	\$34,880,110	\$3,074,776	\$1,658,947
Per Kentucky <u>6/</u>	\$39,613,833	\$36,117,000	\$2,173,557	\$1,323,276
Asset Variance <u>7/</u>	\$0	(\$1,236,890)	\$901,219	\$335,671

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OCTOBER 1, 1986 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare A	Medicare B
Assets October 1, 1994		\$39,613,833	\$34,880,110	\$3,074,776	\$1,658,947
Contribution		\$3,704,137	\$2,979,077	\$157,226	\$567,834
Transfer to TAG/Acordia	<u>8/</u>	(\$22,679,379)	(\$19,969,268)	(\$1,760,345)	(\$949,766)
Investment Return		\$8,822,395	\$7,826,651	\$655,197	\$340,547
Benefit Payments		(\$2,460,599)	(\$2,186,039)	(\$72,636)	(\$201,924)
Transfers		\$0	(\$176,792)	\$321,213	(\$144,421)
Assets October 1, 1995		\$27,000,387	\$23,353,739	\$2,375,431	\$1,271,217
Contribution		\$0	\$0	\$0	\$0
Other Transaction	<u>9/</u>	(\$387)	(\$335)	(\$34)	(\$18)
Investment Return		\$1,348,000	\$1,188,596	\$103,904	\$55,500
Benefit Payments		(\$7,272,000)	(\$7,224,358)	(\$27,931)	(\$19,711)
Assets January 1, 1996	<u>10/</u>	\$21,076,000	\$17,317,642	\$2,451,370	\$1,306,988

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STATEMENT OF MEDICARE PENSION ASSETS
OCTOBER 1, 1986 TO JANUARY 1, 1996

FOOTNOTES

1/ We calculated the Medicare segments assets based on our identification of the Medicare segments and our computed asset fraction (Part A of 6.1203% and Part B of .2501%). We computed the asset fractions as explained in our finding section of the report narrative. The amounts shown for the other segment represent the difference between the total company and the Medicare segments.

2/ We obtained total contribution amounts from IRS Form 5500 reports. Kentucky did not make contributions to the pension trust fund for plan years 1988 through 1993. For plan year 1986 we allocated contributions to the Medicare segments based on the ratio of the segments' salary dollars to total company salary dollars. For plan years 1987, 1994, and 1995, we allocated contributions to the Medicare segment based on the ratio of the segment's CAS funding target to the total company CAS funding target. The CAS funding target is computed in our report of unfunded pension costs (CIN: A-07-98-01224).

3/ We obtained investment return (investment earnings less administrative expenses) from actuarial valuation reports. We allocated investment return to the Medicare segments based on the average asset value each year, weighted for contributions and benefit disbursements as if such transactions occurred uniformly throughout the year. Kentucky used this same methodology.

4/ We obtained total benefit payments from actuarial valuation reports. We based the Medicare segments' benefit payments on actual payments to Medicare retirees.

5/ We identified participant transfers between segments by comparing annual participant valuation listings provided by Kentucky. The listings contained the actuarial liability of each participant at year end. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. We calculated the funding level as the assets divided by the liabilities. If the funding level ratio was greater than one, we transferred assets equal to the participant's liability.

6/ We obtained total asset amounts as of October 1, 1994 from Kentucky's update of assets provided by its actuary.

7/ The variance represents the difference between the OIG calculation of assets as of October 1, 1994 and the assets calculated by Kentucky's actuary.

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STATEMENT OF MEDICARE PENSION ASSETS
OCTOBER 1, 1986 TO JANUARY 1, 1996

8/ In June of 1993, Kentucky merged with the Associated Group (TAG). Discussions were held regarding the merger of the pension plans. As of October 1, 1994 a majority of the Kentucky participants transferred to TAG and/or Accordia, a separate pension plan for the marketing group. We allocated this amount to the Medicare segments based on the ratio of beginning of year market value of Medicare assets to the beginning of years market value of total assets.

9/ In preparing the 1995 IRS/DOL Form 5500 Kentucky elected to round the total company market value of assets to the nearest million. The amount rounded is shown as an "other transaction" in the amount of \$387. We allocated this amount to the Medicare segments based on the ratio of beginning of year market value of Medicare assets to the beginning of years market value of total assets.

10/ We identified Medicare Part A segment assets of \$2,451,370 and Medicare Part B segment assets of \$1,306,988 as of January 1, 1996.